凱基亞洲
KGI ASIA

2023 Q4 Global Market Outlook

Navigating Regional Economic Landscapes

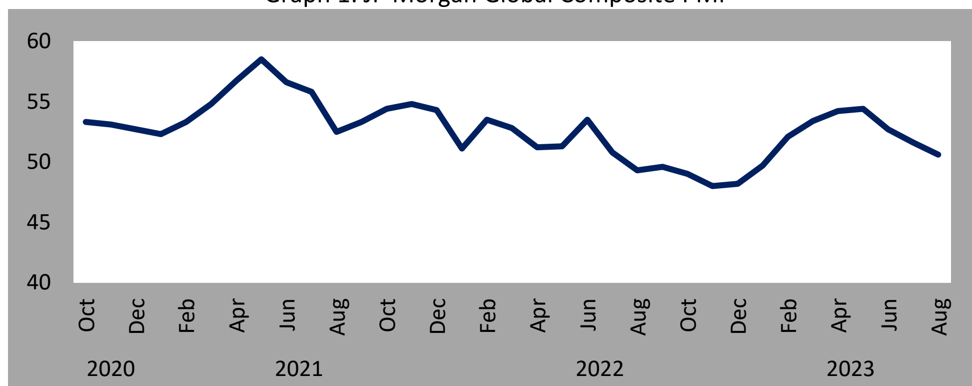
Global Macroeconomic Review and Outlook

Global economy continues to grow, but performance varies by regions

Overall, the U.S. economy performed better than expected with the U.S. Institute for Supply Management (ISM) Non-manufacturing Index rose to 54.5 in August beating the market consensus of 52.5 and recording the best reading since February. The Fed's Beige Book also showed that the U.S. economy expanded at a moderate pace. However, global economic growth was limited due to the slower economic growth of the Eurozone and China.

The fact is, the J.P. Morgan Global Composite Purchasing Managers' Index (PMI) Output Index has dropped to 50.6 in August, from the previous reading of 51.6. Although, readings maintain at expansionary territory for 7 consecutive months, the index had slowed for the third straight months, and it was at the lowest in 7 months. On a regional basis, Asia's economic performance had been relatively solid despite the slower growth of China's economy since 2Q23. However, with more progressive rollout of policies in China and favorable conditions in Japan and India, etc., continued growth in the overall Asian economy is being upheld. In terms of industries, the global manufacturing sector has improved while growth in the service industry has decelerated.

Graph 1: JP Morgan Global Composite PMI



Source: Bloomberg, Prepared by KGI Asia

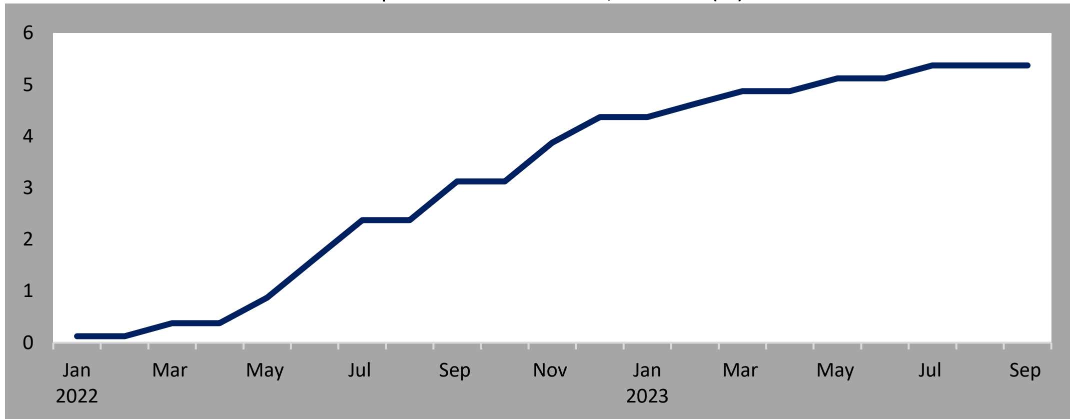
Rate hikes are nearing an end, keep a close eye on coming data

According to the forecasts by the International Monetary Fund (IMF), global economic growth is expected to slow down moderately from 3.5% in 2022 to 3.0% in 2023 and 2024. Such projected growth was revised up from the earlier forecasts and yet it remains lower than the historical average. This is partly because interest rate hike policy adopted by central banks to combat inflation has been weighing on economic activity. When analyzing the global economy, therefore, investors should pay attention to the interaction between the economy, inflation and monetary policy. KGI Asia is of the view that the global economy is projected to maintain solid growth in 4Q. We expect inflation to fall further (with the possibility of core inflation receding slower than previously predicted), and a lower likelihood of more significant monetary tightening in Europe and the U.S.

U.S. economy stable in near term, expected to slow down in medium term

In addition to the service industry index mentioned above, the better- than- expected U.S. consumer confidence supported the U.S.' overall economic performance. The IMF predicts the U.S. economy to grow 1.8% this year. Per our forecast, the U.S. may post a quarterly annualized growth of over 3% for 3Q, and hence soft landing could be extended in the near run. On the other hand, chances are high that the U.S. economy will experience a slowdown in the mid-term, and recession could still occur in the first half of next year. As for interest rate movements, the pricing of interest rate futures still reveals a 20% chance of the Fed raising interest rates further to 5.5% to 5.75%. We believe Fed officials will continue to have a neutral to hawkish tone to manage inflation expectations as well as maintain policy flexibility, meanwhile, the cooling labor market and inflation may allow the Fed to have a rate hike pause.

Graph 2: Fed Funds Rate, Median (%)

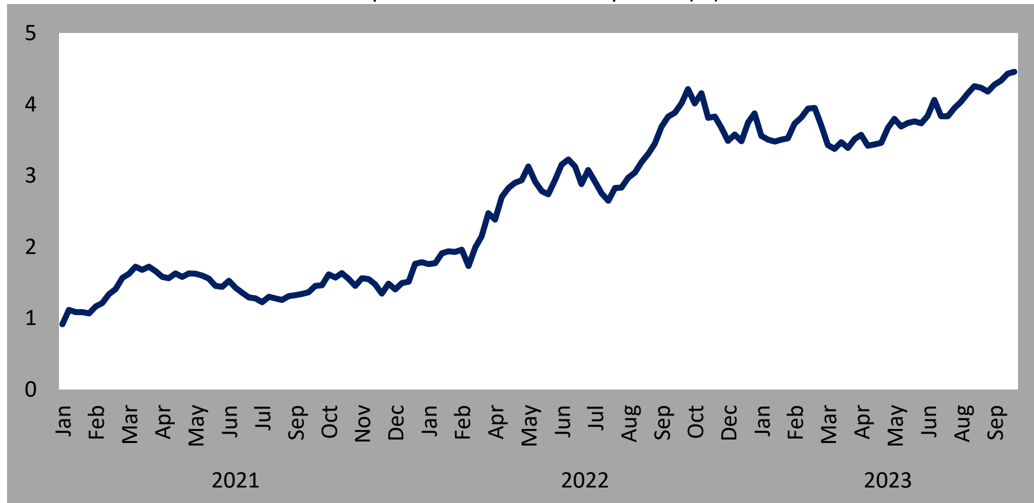


Source: Bloomberg, prepared by KGI Asia

Higher bond yields send volatility to capital markets

Investors should be closely watching bond yields besides the Fed's monetary policy. Most Fed officials believe interest rates will stay at high levels for some time due to the resilience of the U.S. economy. Simultaneously, the U.S. Treasury boosted the size of its treasury sales, which was not quite met with investor enthusiasm. Meanwhile, the Bank of Japan (BOJ) adjusted its monetary policy. All these pushed up the 10-year Treasury yield to over the YTD high of 4.5%, sending volatility to capital markets, in particular to the bond market.

Graph 3: 10Y U.S. Treasury Yield (%)



Source: Bloomberg, prepared by KGI Asia

European economy is disappointing

The Eurozone's final composite PMI fell to 46.7 in August, the largest drop in 3 years and short of the preliminary figure of 47. The market worries that the German economy may shrink more this year than previously expected, as Germany's manufacturing sector is feeling the impact of declining global demand and rising interest rates. The IMF forecasts that the Eurozone and German economies will grow by 0.9% and contract by 0.3% this year, respectively.

Investment strategies for 4Q23

Looking forward to 4Q, the U.S. is nearing the end of its interest rate hikes, and the odds of a soft landing are increasing. Some emerging markets have taken the lead in cutting interest rates. Our investment focuses for 4Q23 are as follows:

Emerging markets have emerged as pioneers in entering the interest rate cutting cycle to support the economy

At the start of the year, we pointed out that investors might consider diversifying their allocation to the Asian market, as there are many high-growth countries in the region, and the decentralized production lines of large global companies are expected to support growth in the region.

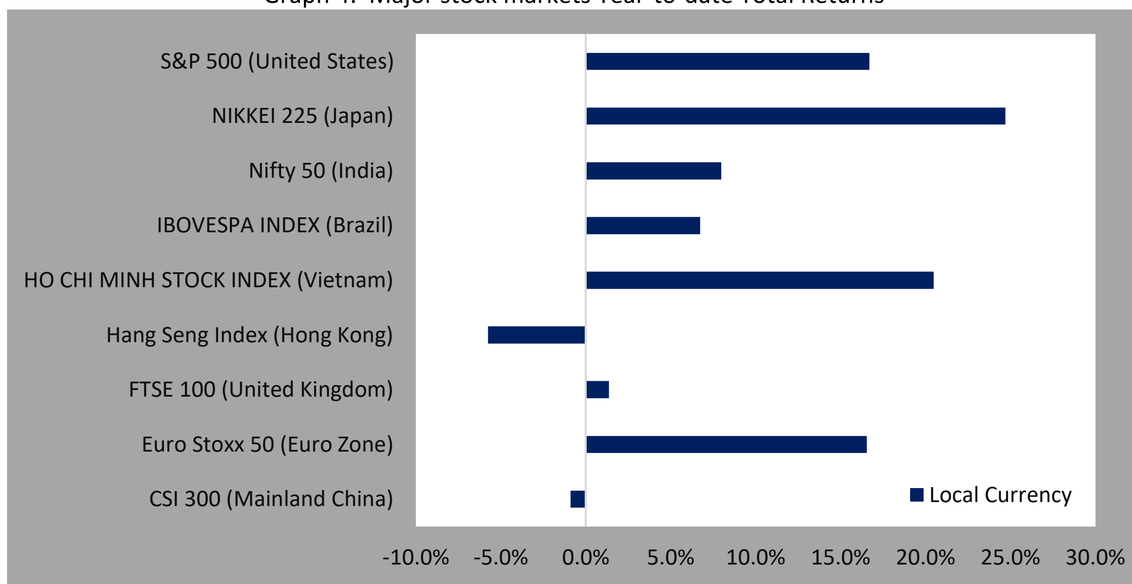
India and Vietnam are the growth engines in Asia. Both countries are adopting looser monetary policies to support economic growth. The Reserve Bank of India (RBI) announced in August that it would keep interest rates unchanged at 6.5% for the third time in a row. This year, Vietnam has cut interest rates several times to offer the market lower financing costs. As of August 31, the MSCI India and Vietnam indices were up 6.2% and 17.5% YoY in USD, respectively. We believe both countries will continue to benefit from the China-U.S. dispute.

Recently, China has rolled out a number of measures to revive its economy, including lowering stamp duty on securities trading and relaxing mortgage restrictions. The latest RMB softness can support exports in certain extent, while the expansionary monetary policy may potentially stimulate the weak economy. Given that China and Hong Kong stocks are trading at low valuations, they are worthy of attention.

Brazil and Chile in emerging Latin America, with attractive valuations, are also expected to enter interest rate- cutting cycles soon. However, having accumulated apparent gains YTD, coupled with their high correlation with raw materials, their capital markets tend to be more volatile. Investors should manage their investment amounts with great care when investing in these two markets.

Emerging markets offer high growth potential, but also have higher volatility and greater policy and exchange rate risks. we recommend investors to invest in stages.

Graph 4: Major stock markets Year-to-date Total Returns



Source: Bloomberg, prepared by KGI Asia

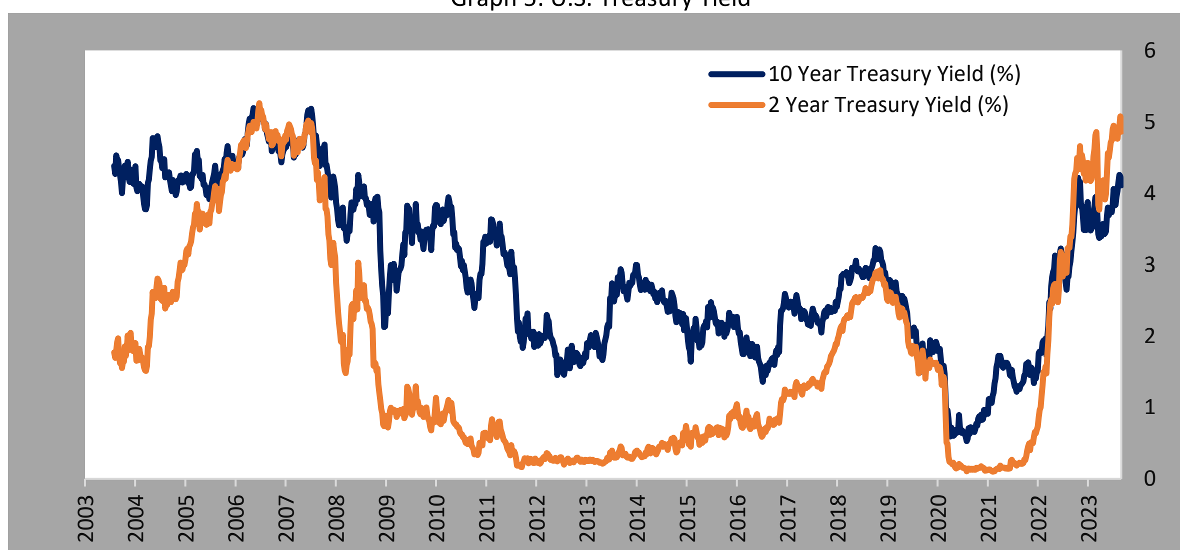
Capitalize on investment-grade bonds' rising yields

The decline in inflation has started to plateau. Coupled with the resilience of the U.S. economy, the market is expecting the Fed to keep its target rate at a high level for a relatively long period of time. Also, the debt ceiling issue was resolved temporarily at the beginning of the year, by which the U.S. Treasury Department has boosted the size of its bond sales, and therefore draining funds from the market. Market expectations, together with supply and demand factors, have caused bond yields to climb persistently.

The fluctuation of asset prices due to the rising bond yields, can in fact be translated to investment opportunities. By the end of August, the 2-year and 10-year U.S. Treasury yields stood at 4.86% and 4.11%, respectively, the highest since 2008. The interest rate risk of short-term bonds is relatively low. Investors may consider allocating to bonds of different maturities based on their own investment horizons and risk tolerance. For example, investors who are more conservative or have short-term funding needs may opt for short-term bonds to reduce price risks and capture the higher yields. Moreover, given that interest rates could peak in the near future, investors who are more aggressive or have longer investment horizons may consider purchasing mid/long-term bonds in phases, which can help decreasing future reinvestment risk, and even enable them to enjoy potential price increases if interest rates fall in the future.

It is worth mentioning that the yield on three-month Treasury bills is 5.5% at present. For investors who want to earn the yields on short-term debts, they may consider money market funds. In general, money market funds can help investors diversify their investments into short-term, high-rated fixed income instruments with a maturity of 3 months on average.

Graph 5: U.S. Treasury Yield



Source: Bloomberg, prepared by KGI Asia

Advantages of global large-caps stand out in slowing growth

Strong U.S. retail sales data has further reduced expectations of a U.S. economic recession, which increases the upside of the stock market. Yet, the current high interest rate environment is relatively unfavorable for small and medium-sized enterprises, due to high financing costs. Even if a soft landing is now a much more likely scenario, the chances of recovery in the coming quarter are limited, and therefore the environment remain unfavorable for the small and medium-sized enterprises.

Global large-cap stocks derive their profits from relatively diverse streams. For instance, the forward P/E of the MSCI World Index for developed markets remains at its 10-year average, showing a relatively fair valuation.

In addition, AI-related and technology stocks have experienced considerable gains. Currently, the risk of investing in a single sector is rather high, so it would be better to diversify and manage the amount of each bet cautiously.

Graph 6: MSCI World Index – Estimated Price-to-Earnings Ratio

Source: Bloomberg, prepared by KGI Asia

Japan's inflation is not yet on target, expansionary policy maintained

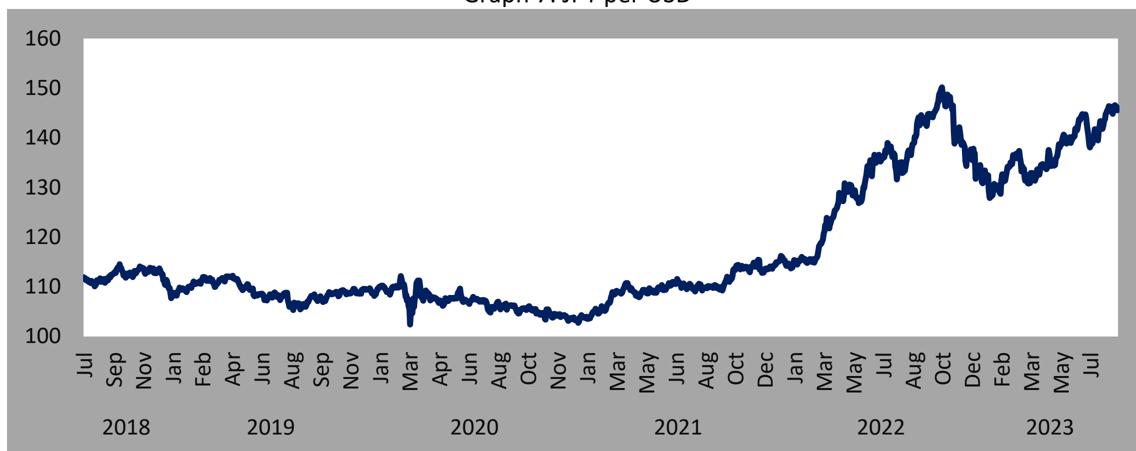
At the beginning of the year, we rated Japan as a buy among Asian markets, due to the attractive valuations of Japan stocks. As of August 31, the Nikkei 225 had risen about 25% YTD, in JPY. Despite the index's considerable gains, the Japanese market shows a forward average P/E of about 21x, similar to its long-term average P/E. This implies the continued upward revisions of corporate earnings forecasts.

Inflation in Japan came in at 3.2% in Aug, the 17th consecutive month above the Bank of Japan (BOJ)'s 2% target. Although the BOJ has widened its target range for 10-year Japanese government bond yields, Japan's monetary policy remains loose, being a good news for enterprises. The JPY continues to hit new lows against the USD, favorable for Japanese exports. In the medium to long term, it is forecast that Japan's enterprises will still be supported by mild inflation and corporate governance reforms, etc.

Since Japan is a developed market, for investors who are bearish on JPY/USD, they may consider hedged share classes when investing in the Japanese market to lower currency risk. Some of those funds even provide investors with the opportunity to earn the interest rate spread between the U.S. and Japan. But investors should be aware that the BOJ could reverse its monetary policy and that the JPY could appreciate.

Individual investors do not commonly have long positions in Japan stocks. This is mostly because funds focused on investing in Asia often exclude Japan, and Japan stocks may only account for 5% of the holdings of global equity funds. Hence, investors should review the composition of their portfolios.

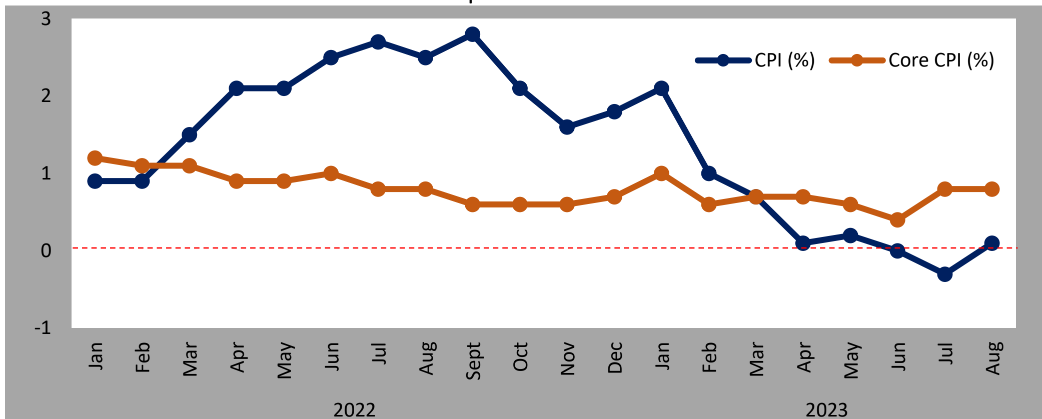
Graph 7: JPY per USD



Source: Bloomberg, prepared by KGI Asia

China Economy

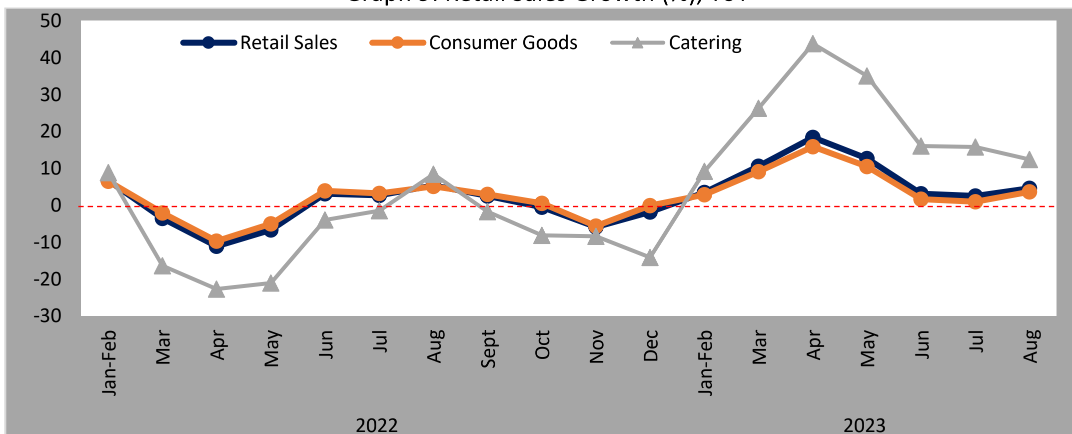
Graph 8: China CPI



Data: National Bureau of Statistics, Prepared by KGI Asia

Lately, China's consumer price index (CPI) rose 0.1% YoY. In fact, the CPI turned negative in July, raising market's concern on China's deflation risk. Market consensus is that the consumption in China is not as strong and stable as expected. In August, consumer goods inflation dropped 0.7% YoY, while services price turned out to be better with a YoY increase of 1.3%. Overall, China's CPI in 2023 was dragged down by the lower goods prices and worsened by the high base effects of hog and oil prices last year. The high base effect of hog prices is expected to be an issue until November, meanwhile, that of oil prices is expected to fade gradually. Investors could keep track of the core CPI, which excluded food and energy.

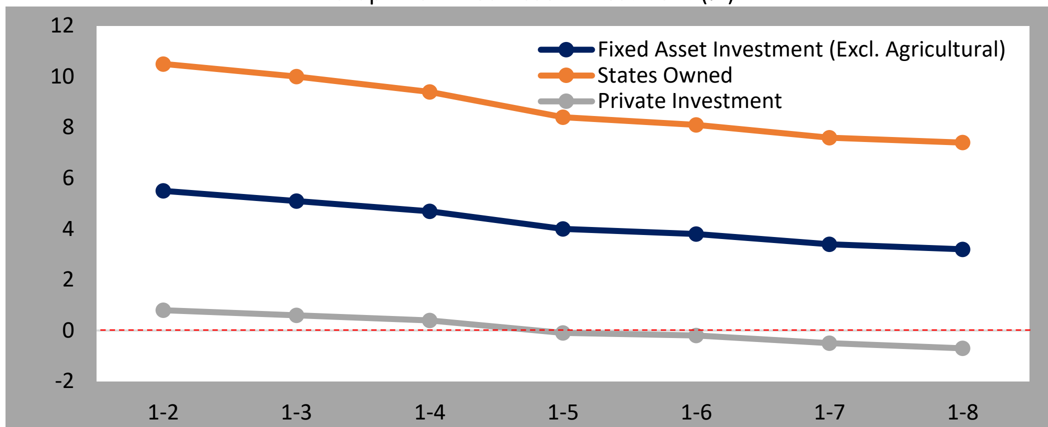
Graph 9: Retail Sales Growth (%), YoY



Data: National Bureau of Statistics, Prepared by KGI Asia

In terms of retail sales of consumer goods, the consumption had once entered a booming cycle benefit from the China relaxation of the COVID measures. However, the growth in consumption began to soften after peaking in April. The data remain greatly weaker than the pre-pandemic's high single to double digits. This reflects insufficient consumption demand, also explains the aforementioned low inflation of goods. With a low base effect coming in 4Q23, we expect the growth of retail sales to gain momentum for the remaining months of 2023.

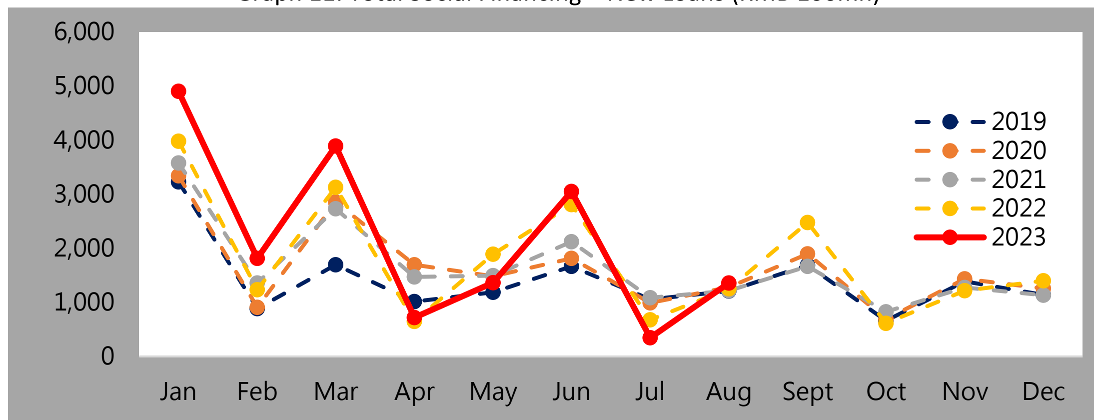
Graph 10: Fixed Asset Investment (%)



Data: National Bureau of Statistics, Prepared by KGI Asia

China's economic data is intertwined. Fixed asset investment continues to show weakness, with the growth mainly driven by state-controlled investment and overall speaking, a downtrend was formed. The fixed assets investment by the private sector started to record negative growth in May, revealing the market's lack of confidence in future economic development, due to the fact that China's economic rebound has not been as robust as predicted, at the same time, the external economy is slowing down.

Graph 11: Total Social Financing – New Loans (RMB 100mn)

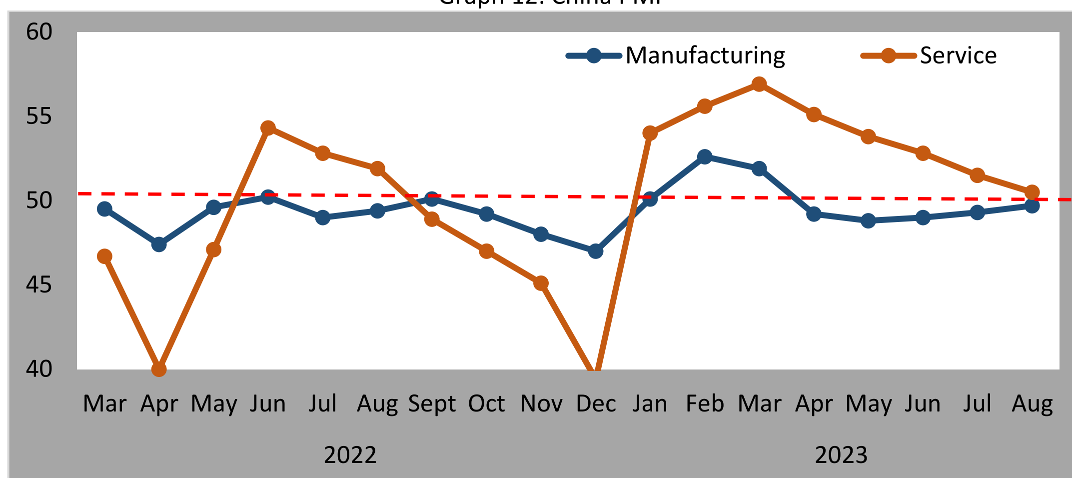


Source: People Bank of China, Prepared by KGI Asia

Such lack of confidence is also mirrored in the trend of Total Social Financing.

The July figure was far lower than expectations of RMB1.1 trillion, with only RMB528.2 billion, the lowest for the same period in recent years, as a result of lower consumption loans from the household. Furthermore, as we know, corporate loans account for a large part of RMB loans. Its July data continued to be affected by the cyclical phenomenon of weaker for quarter-start and stronger for quarter-end, though performance was weaker than the past. The August figure was in line with market expectations. As mentioned, quarter-end is the peak season for corporate loan issuance, and therefore the upcoming September results might provide more indicative information to the market. Looking back, both the March and June figures beat market expectations. This might also happen to the upcoming September results, and therefore investors don't need to be overly pessimistic.

Graph 12: China PMI



Source: People Bank of China, Prepared by KGI Asia

As for China's PMI in August, the manufacturing index came in at 49.7, and the non-manufacturing at 51, versus the projected 49.4 and 51.1 respectively. The performance of the manufacturing sector was slightly better than expected, and the level of contraction continued to narrow. The new orders index also moved back above the 50.0 mark, showing improved demand. For the Ex- factory prices, after five consecutive months of being below 50, it has rebounded to 52. This could be signs of stabilization in industrial prices, but of course, it needs support from the subsequent new orders index. For the non-manufacturing sector, the services PMI fell further to 50.5 in August, close to the dividing line between expansion and contraction. The expansion had narrowed for 5 straight months, and therefore, subsequent growth of the services industry is in doubt.

Although the Chinese economy began to show weakness in 2Q23 and the real estate debt crisis resurfaced in 3Q, leading to pessimism about the market outlook, the Chinese government is speeding up the introduction of stimulus policies targeting different sectors.

Looking ahead, we expect more policies to be launched in the coming months. Considering the lagging effect of policies, we expect the impact to be reflected in the economic data by the end of 2023 Q4.

4Q23 Hang Seng Index Forecast

2H23 EPS expect to rise

As of the end of August, a total of 71 Hang Seng Index (HSI) constituent stocks had announced interim or second quarter results. The weighted adjusted earnings per share (EPS) have increased by 21.6% YoY. We expected the earnings growth will accelerate to 28% in 2H23, and full-year growth of 13.1% to HK$2,100 per share, which is approximately the same as what we expect in our 2H23 market outlook, which was published in June.

Forward P/E ratio revised slightly downward

Given EPS of HK$2,100 and the assumption of the index level to be above 18,000 by the end of September, the corresponding forward P/E ratio will be at around 8.6x. To recap, we estimated the forward P/E ratio to be at 10.6x when we published our 2H23 market outlook report. Yet the HK share market retreated in recent months, dragging the forward P/E ratio to a lower level. Considering the historical quarterly rebound level of the HSI, it is unlikely for the forward P/E ratio to rebound to such a large extent on a quarterly basis. Therefore, we adjusted the forward P/E ratio downward to 9.3x, which represents a quarterly valuation increase of 9.0%.

The target price of FY23 is 19,600 in 4Q23

Corresponding to the 9.3x forward P/E ratio of in FY23, we estimated that the base case of the HSI at 19,600, with a potential upside of 9.0%. Meanwhile, if the massive stimulus fails to revive the ailing property market, the forward P/E ratio may fall to 8.0x due to sluggish market sentiment. The corresponding index would be at 16,800, with a potential downside of 6.6%.

Our Stock Picks for 4Q23

China Mobile (941): With a continuously rising share of revenue contribution from digital transformation, the revenue structure of China Mobile has become more balanced and robust, and the momentum for sustainable growth has been enhanced. Having a moderate growth in capital expenditure, its net profit margin is expected to rise steadily. The company has a promise to increase the dividend payout rate to 70% in 2023. China Mobile is a pick with high growth visibility and attractive dividends.

Kuaishou (1024): Average DAUs and MAUs on the Kuaishou App reached 376.0mn and 673.3mn, representing a yoy increase of 8.3% and 14.8%, respectively, taking the scale of user community to a new record high. Driven by the increase in the number of users, the strengthening of monetization capabilities, and the optimization of operational efficiency, Kuaishou achieved the first-ever group-level net profit in a quarter. The profit in 2Q23 was RMB1.5bn, compared to a loss of RMB3.2bn for the same period of 2022.

Baidu (9888): Total revenue of Baidu in 2Q23 were RMB34.1bn, increased 15% yoy. Non-GAAP net income attributable to Baidu was RMB8.0bn. Overall, both revenue and profit beat expectations. Baidu is well-positioned to capitalize on the opportunities arising from generative AI and LLM, which may help Baidu improve user retention and benefit its advertising business in long run.

HSBC (5): HSBC's second-quarter performance continued to show strength, with quarterly revenue of USD16.71bn, increased 36.5% yoy. Both interest and non-interest income grew by more than 34%. For 1H23, HSBC achieved annualized return on average tangible equity (RoTE) of 22.4% compared with 10.6% in 1H22. HSBC announced a second interim dividend of $0.10 per share and had a further share buy-back of up to $2bn, which it expects to complete within three months.

Trip.com (9961): Net Revenue of Trip.com in 2Q23 was RMB11.2bn, up 180% yoy and 22% qoq, mainly due to the significant recovery of the tourism market. Non-GAAP net income attributable to shareholders was RMB3.4bn, compared to net loss of RMB203mn for the same period in 2022 and net income of RMB2.1bn in 1Q23. Overall, the company has recovered from pandemic and is tapping into the potential of the inbound travel market.

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